

Formula Grant consultation

19 July 2005

The government today (19 July 2005) published a document on changes to the formulae used to distribute grant to English local authorities.

The consultation document is available via the internet at
<http://www.local.odpm.gov.uk/finance/0607/consult/index.htm>

The consultation will run to 10th October 2005. The LGA will be submitting a formal response to the consultation. Authorities are asked to let us have sight of their responses, by 30th September 2005.

Please note that the LGA is holding a conference concerning the main changes proposed on 7th September 2005; details can be obtained from
<http://www.lga.gov.uk/Event.asp?lsection=46&id=SXA5B7-A782F440>

Form of the consultation

The document contains 37 questions. 49 options for changes to grant formulae are presented, covering all the main services and a number of cross-service issues. Most of these changes have been discussed in the Settlement Working Group or in similar groups covering Fire and Police.

All SWG papers can be accessed online at
<http://www.local.odpm.gov.uk/finance/0607/grant.htm>

The Government has said that it will not necessarily limit itself to the options in the consultation paper. Respondents have been asked for their views on the options in the consultation document as well as any alternative proposals.

Most options are exemplified on the basis of its effect on 2005/06 Formula Spending Share for each local authority without the Schools FSS block; the options for additional resource equalisation and floor damping show the effect on formula grant after floors assuming transfer using option SCLT1, as outlined below.

These are not the figures that will appear in the 2006/07 local government finance settlement, because of changes in the overall funding totals and because there will be changes to data such as population which will not be available until later this year.

Education

Funding for schools from 2006/07 will be through the Dedicated Schools Grant, meaning that there will no longer be a Schools formula spending share. This will have an effect on grant for non-schools services, primarily because some authorities spend over and some spend under Schools FSS (Authorities as a whole spent over £200m above Schools FSS in 2005/06).

Two exemplifications are included:

- ❑ taking out schools budgets at a figure midway between schools spend and school FSS (£95m less than schools spend in 2005/06) and applying floors as they were in 2005/06 to the remaining amount; (SCLT1)
- ❑ as for SCLT 1, but with a top up provided so that no authority receives less grant for non-schools services than it would have had the transfer not gone ahead. (SCLT2).

Comments are sought on the proposal to adjust the base using spend, rather than FSS figures and to isolate police, fire and shire district authorities from the effects of the transfer.

We are expecting an announcement from DfES on schools' funding within the next few days. A separate briefing will be circulated on this.

LEA block

The LEA block of the Education FSS will not be affected by the introduction of Dedicated Schools Grant. Three minor changes are proposed to this formula.

- ❑ updating sparsity data from 1991 census to 2001 census (EDU1);
- ❑ take residual FE pensions out of the formula (EDU2);
- ❑ consider removing the LEA damping block, which has been in the formula since the last changes in 2003/04 (EDU3).

New Grant systems

This is a proposal to move away from notional measures of spend (Formula Spending Share) and council tax (Assumed National Council Tax). Instead relative differences in needs and resources would be measured through indices. Grant would be split into a needs element, a resources element and a basic amount as well as a damping block. The basic amount would be the same, per head, for all authorities which provide the same services.

These could be weighted to produce the same result as the existing FSS but if their weight against each other were to be set judgementally at a different level it would produce a different distribution.

Service blocks and formulae would remain, but would be calibrated to an index as opposed to scaled to control totals.

When this was discussed by the Settlement Working Group, the general view on the local government side was that this would make the system less rather than more transparent. However it is included as an option in the consultation document.

Three year settlements

The government has also announced its conclusions following the consultation on three year settlements earlier this year. The government proposes that the settlement to be announced in autumn 2005 should cover the two remaining years of Spending Review 2004 (2006/07 and 2007/08). From 2008/09 three year settlements will be fully aligned with the spending review cycle. As was announced today, the next spending review will be in 2007.

As far as formula grant is concerned, the proposal is to use projections for both population and council taxbase. The 2006/07 settlement will use taxbase figures for 2006/07. Following the council tax revaluation, in 2007/08 the revalued figures will be used with projections for 2008/09 onwards. It is proposed to freeze other data based on multi-year averages. Figures will not be revisited in subsequent years

except in “entirely exceptional cases”.

The Government made a separate announcement on three year settlements (see http://www.odpm.gov.uk/pns/displaypn.cgi?pn_id=2005_0139). The following should also be noted:

- ❑ move to greater certainty on forward indications of council tax levels.
- ❑ specific revenue grants to be allocated on a three-year forward basis.
- ❑ capital funding to be allocated on a three year forward basis except for emergencies and large one-off projects.

2004/05 and 2005/06 amending reports

The Government proposes an amending reports for 2004/05 and 2005/06, to take account of the change of ONS population estimates, along the same lines as that issued for the 2003/04 settlement in 2005. Some other data errors will corrected at the same time.

Personal Social Services

The changes here are among the most significant, in terms of their distributional consequences, in the consultation document. They are derived from work carried out for the DH and the DfES by academic researchers.

The DH intend to bring forward a paper for discussion in the autumn on damping changes to specific grants which use FSS formulae as their distribution mechanism.

Children

Proposals for changing both the main needs formula and the adjustment for higher foster costs are based on an analysis of the 2003 Children in Need survey.

For the main needs formula, the proposal uses a small area (postcode district) analysis and national unit costs. The factors proposed in the formula are children without good health, adults and children in families on income support or jobseekers allowance, children in black ethnic groups and density. (SSC1)

Two options for updating the top up for fostering costs are proposed, following analysis of the 2003 data. Both use a mixture of indicators for ethnicity, low qualification, and females 16-74 looking after homes and families. (SSC2 and SSC3). It is also proposed to increase the weight given to the foster cost adjustment from 19% to 20% in line with the latest data.

In view of the substantial distributional implications of these proposals, there is a question as to whether there should be damping with the Children’s FSS formula, with floors and either ceilings or scaling factors to limit the extent of the changes.

Elderly people

Two approaches to updating this formula are proposed. The first (SSE1) uses an individual level analysis, similar to the existing formula; based on predicting what factors are most likely to mean that elderly people require social services. Work on this analysis is still proceeding and it is expected that a further recommendation will be modelled in September.

The second (SSE2) uses a small area analysis with a much larger sample but with less detailed information on each case.

Despite the differences in statistical approach and sample size; the factors recommended in the two models are similar: relating to age, single living with others, renting in the public or private sector, having a limiting long-term illness, being in receipt of pension credit or attendance or disability living allowance.

Proposals are made to update the low income adjustment with 2001 census data (SSE3)

Finally; there are two options for the sparsity top slice. One (SSE4) would use 2001 census data and the other (SSE5) would use a distance-based measure that came out of the work by MSA Ferndale commissioned by the Countryside Agency. There is also a question on increasing the sparsity top-slice to more than 0.4%

Younger Adults

Two options are presented for a new formula. They both use small area analysis of over 25,000 up to date records of service clients and move away from the current formula, which is based on an analysis of past spending.

The two options differ as to whether they aim to predict numbers of clients or costs. Both use similar needs indicators. Disability living allowance and no-family households were the strongest variables statistically and are common to both. In addition, the model based on predicting the pattern of authority costs (SSA1) adds black ethnicity; and the other one, which is based predicting numbers of clients (SSA2), adds unemployment and routine occupation.

Police

The paper contains four options for change (POL2-POL5). The first three are based on reviewing crime categories in line with the Police Performance Action Framework, POL2 uses a workload weighting for different types of crime based on seven crime categories. POL3 contains six categories, identical to the previous option, except that the categories for robbery and serious violence and sexual crimes are amalgamated. POL4 is based on the seven crime categories but has a simplified formula with only 6 variables. POL5 is a less radical option using the existing incident model.

Also included is a shift of around 2% from FSS to pay for dedicated security posts and the removal of the police pensions element (POL1).

Fire

ODPM have developed a number of options in conjunction with the Fire Formula Working Group. They are:

- ❑ remove the element for fire pensions and rebalance the other elements (FIR1);
- ❑ dropping the indicator for 'A risk' areas, which no longer exist and replacing them by one relating to hazardous (COMAH) sites (FIR2);
- ❑ replace the current fire safety enforcement element with a measure of either household or societal risk (FIR3) and consider doubling the weight of the fire safety element (FIR4);
- ❑ using longer averages for the house condition data in the fire risk index (FIR5);
- ❑ modify the risk index indicator to use 5-year average data (FIR6) or replace indicator covering household types likely to contain single parents and older people (FIR7);
- ❑ introduce a judgemental sparsity element with a 1% weight, in recognition of the fact that authorities with large numbers of retained fire-fighters, which tend to be those in areas with higher sparsity, find it more difficult to make savings from the fire modernisation process (FIR8).

Highway Maintenance

Relatively few changes to this FSS block are proposed. An average of three years for traffic flows are proposed (HM1) and all data will be updated so as to include 2001 census data (HM2). There is also an option for including back lanes within the formula; at an amount half that of built up roads but not multiplied by traffic flows (HM3).

Environmental, Protective and Cultural Services (EPCS)

Weights for the EPCS blocks are set by judgement. It is proposed to update for 2001 census data but to change the weight given to the indicators so as the share distributed by each should remain constant (EPCS1).

Additionally, it is proposed to revisit the judgemental weights in the EPCS district block so as to reflect the need to spend additional money to be allocated to **concessionary fares** (£350m) in order to finance free concessionary fares for people over 60 and disabled people, as announced in the 2005 budget. (EPCS2) The weights on density, pensioners on income support and incapacity benefit would be increased.

The document notes that some work has been done to show that the main explanatory factor in the distribution of **waste** collection expenditure between authorities is resident population and asks whether any further judgemental adjustments to coefficients should be made to take account of this. There is no option for a separate waste block included and the document states that ODPM take the view that to split up EPCS into single service blocks would be undesirable

On **flood defence**, there is a proposal to adjust the flood elements so as to reflect the transfer to the Environment Agency of critical ordinary watercourses (COWs). (FD1) Defra have embarked upon a separate consultation lifting the cap on the residual Environment Agency levy (set at 3 times the FSS) on condition that the EA be directed that any levy must have the majority consent of local authority members of regional flood defence committees.

Finally, there is a proposal to uprate the fixed cost element from £300,000 to £325,000, in recognition of the cost increases since the element was introduced in 2003/04. (FC1)

Capital Financing

Formula spending shares include two 'negative' blocks, for interest receipts and interest on reserved capital receipts, both within the capital financing block. A proposal is included to remove these. The document states that the interest on capital receipts element could, over time, act as a disincentive to holding prudent balances and that the interest on reserved capital receipts element is outdated as it reflects the previous capital regime.

Respondents are asked for their views on removing one or both negative elements.

Different options are set out. CF3 removes the negative elements without any adjustment (thus increasing FSS). CF2 would reduce the debt charges element by the amount of the negative blocks. CF3 scales the non capital-financing blocks down.

Area Cost Adjustment

Five options are presented

- Use the full Annual Survey of Hours and Earnings database as opposed to a sample (ACA1); (ASHE is the successor to the New Earnings Survey (NES));

- ❑ Either update the weight given to the element of the Area Cost Adjustment for non-domestic rates (ACA3) or remove it altogether (ACA2);
- ❑ Change ACA geography so as to calculate a separate ACA for each upper tier authority. This could be done with the existing lower limit (ACA5) or restricting it so that only authorities with higher than average wage pressures would get an area cost adjustment (ACA4).

Additional Resource Equalisation

The grant distribution system takes account of the relative ability of different councils to raise council tax, known as resource equalisation. It does this by setting an assumed national council tax. In 2005/06 ANCT was assumed to be £1,102 but average band D council tax was 10% higher at £1,214.

Two options are presented for bridging the gap between assumed national council tax and average council taxes. RE1 would increase the personal social services FSS by £1635m, fire by £55m and police by £358m. RE2 would halve these increases. RE3 is a combination of RE1 and abolishing the interest receipts blocks in the capital financing FSS.

The document notes that resource equalisation distributes more grant towards high needs, low council tax base authorities and states that there is an equity rather than a technical reason for more resource equalisation.

It should be noted that if the ODPM alternative grant system was to be adopted resource equalisation would not exist in its current form; but the same result could be obtained by changing the weights of the indices, both as regards their service composition and their weight within the grant equation.

Floor damping

ODPM proposes to remove the adjustment for capital spending; their view is that this was put in when there was a grant ceiling and that there is no longer a justification for it (DMP1).

Alternative methods of working out the minimum increase are outlined, alongside the alternative grant system. Damping could continue in much the same way at present; in other words a minimum increase on the previous year's total grant. Alternatives presented are:

- ❑ damping would be based on the effect on Band D council tax (DMP2)
- ❑ floor increases would apply to the basic amount of grant per head only; in other words the element of the grant which does not compensate for higher needs or lower resources (DMP3);

Data

One data matter is included; whether the day visitors should be updated in line with work carried out for ODPM, using visits from outside a 10 mile radius (D1). Although these new figures are based on more recent data, concern has been expressed over their plausibility.

For further information contact: Mike Heiser mike.heiser@lga.gov.uk 020 7664 3265 or Corin Thomson corin.thomson@lga.gov.uk 020 7884 3188